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Supreme Court of the United States

October Term, 1976
No. 76-968

POPULAR SCIENCE PUBLISHING COMPANY, INC.,

Appellant,

vs.

BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,

Appellee.

On Appeal From the Court of Appeal of the State of California, Second Appellate District [Division Four]

MOTION TO DISMISS OR AFFIRM

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vs.

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On Appeal From the Court of Appeal of the State of California, Second Appellate District [Division Four]

MOTION TO DISMISS OR AFFIRM

Appellee Board of Equalization of the State of California, pursuant to Rule 16 of the Revised Rules of the Supreme Court of the United States, moves the Court to dismiss the instant appeal or to affirm the judgment of the Court of Appeal of the State of California.

There is no substantial federal question presented as a basis of jurisdiction inasmuch as the questions were properly decided below on the basis of previous decisions of this Court. In this regard, the decision of the District Court of Appeal of California correctly applies the principles set forth in the cases of *Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359 (1941); *Nat.*

Bellas Hess v. Dept. of Revenue, 386 U.S. 753 (1967) and *Standard Steel Co. v. Washington Revenue Dept.*, 419 U.S. 560 (1975). The case of *Miller Bros. Co. v. Maryland*, 347 U.S. 340 (1954), which appellant contends is contrary to the opinion of the District Court of Appeal of California herein, is distinguishable from and not inconsistent with the said opinion.

Question Presented

Appellant Popular Science Publishing Company, Inc. (hereinafter "Popular Science") has not fairly stated the question presented herein. The question presented is the following: Whether Popular Science's activities in the State of California provided sufficient nexus to support the constitutional imposition of a use tax collection liability measured by Popular Science's gross receipts from its sales of books from its New York offices to California residents during the year 1965.

The Facts[1]

The factual information contained in the record on appeal herein is all set forth in a Stipulation of Facts [CT 16-19], the depositions of Adele Bercovici and Robert D. Cole and the Handbook [Ex. 1]. The Stipulation of Facts is set forth herein and the depositions are contained in the Appendix herein for the convenience of the court.

"1. On or about October 19, 1971 Popular Science Publishing Company, Inc. ('Plaintiff') paid to Defendant under protest the sum of twenty-

[1]The only year in dispute is 1965. All references will be deemed to the taxable year. All the relevant facts are contained in the Stipulation of Facts and the two depositions before the court below.

five thousand eight hundred seventy-five dollars and twenty-eight cents ($25,875.28), the amount of sales and use tax, interest and penalty allegedly due on sales of books by Plaintiff during 1965 to its book club members in California.

"2. Plaintiff was in 1965 and still is a corporation organized under the laws of the State of New York and maintains its principal place of business in New York. During 1965 Plaintiff was engaged primarily in the business of publishing and distributing through the United States and foreign mails and through news vendors the monthly magazines 'Popular Science' and 'Outdoor Life.'

"3. Plaintiff also sponsored during 1965 the Popular Science Book Club and the Outdoor Life Book Club, the memberships of which to a significant extent were composed of readers of 'Popular Science' and 'Outdoor Life.' The book clubs offered members, on a monthly basis, a choice of hard and soft cover books dealing generally with subjects similar to those treated in Plaintiff's two magazines.

"4. In addition, during 1965 Plaintiff produced and sold instructional film strips and other audio-visual educational aids which dealt with subjects appropriate to secondary school curricula ('instructional materials') exclusively through A-V Division ('A-V'). A-V was set up in 1965 to market instructional materials. A-V became a separate corporation on January 1, 1966.

"5. During 1965, A-V's instructional materials were sold to customers, primarily secondary schools, on the basis of orders received at Plain-

tiff's New York office and fulfilled from its inventories located outside the State of California. Commencing on April 16, 1965, A-V employed two salesmen in California whose duties and activities were always confined to the sales of A-V instructional materials only. The A-V salesmen lived in and traveled throughout California contacting prospective customers which were in the main schools and other educational institutions. Such customers of A-V instructional materials had no relationships of any kind with either of Plaintiff's book clubs, although some may have been subscribers to either or both of Plaintiff's magazines. The A-V salesmen did not promote or make any customer contacts on behalf of the magazines or either book club, were in no way involved in processing orders of or collecting from the magazine subscribers or book club members, and had no operational connection of any kind which in any way related to the plaintiff's magazines or book clubs. The A-V salesmen's employment related exclusively to the sale of A-V instructional materials.

"6. California subscriptions to 'Popular Science' and 'Outdoor Life' were generated either through the subscriber's own initiative or as a result of mail or media advertising emanating from Plaintiff's New York office, while newsstand sales were made be [sic] independent retail vendors supplied by a New York distributor which purchased the magazines from Plaintiff at wholesale. Book club memberships were solicited exclusively through the mail from New York, and book sales were made on the basis of orders sent by mail

to Plaintiff in New York in response to periodic mailings of brochures to members describing the current selections available.

"7. All 'Popular Science' and 'Outdoor Life' subscription and book orders were received and accepted by mail at Plaintiff's New York office and filled by mail directly to the subscriber or member from Plaintiff's printers located outside the State of California. Plaintiff maintained no office in California through which any aspect of its magazine publishing or book club business was conducted, and Plaintiff had no employee or independent contractor in California in 1965 on a permanent or temporary basis who promoted, or in any manner was connected with or assisted, in the sales to California residents of 'Popular Science' or 'Outdoor Life' or any offering of either book club."

Popular Science was a New York corporation which published and distributed nationwide two magazines, "Popular Science" and "Outdoor Life." Retail sales of these magazines were made in California. It operated two book clubs bearing the same name as the magazines, and it also distributed nationwide, and sold on a local basis certain audio-visual materials to schools and libraries. There was only one legal entity, and all the above functions were performed by employees of that single entity. Operations were broken down into departments or divisions, but each division or department manager was directly responsible to the officers of Popular Science (Deposition of Cole, pp. 6-7; Deposition of Bercovici, p. 5). The administration and payroll were done by the corporate entity, Popular

Science. All personnel were employees of Popular Science, not of any particular division (Deposition of Cole, pp. 8, 12).

Popular Science's offices were located in New York, with all divisions occupying the same address. These divisions operated separately to the extent a particular product was handled within the division. However, all work was performed for only one entity—Popular Science. The book club operated in the usual manner. The book club service could reasonably be described as a mail order operation. The audio-visual operation engaged in local retail selling in California, utilizing two salesmen who were physically present in this state. These salesmen were employees of Popular Science and were paid by Popular Science's payroll department. They received no money from the division (Deposition of Cole, p. 12).

Adele Bercovici was the general manager of the book clubs of Popular Science which was a division of the company. The other two divisions were magazines and audio-visual (Deposition of Bercovici, pp. 5-6). There was the Popular Science Book Club and the Outdoor Life Book Club. Membership in the clubs was obtained by subscriber solicitation, outside mailing lists and advertisement in the magazines published by Popular Science. The subject matter of the books was that of the respective magazines. The company sold and distributed the books to the members through the mails (Deposition of Bercovici, pp. 7-8). All of the personnel connected with the book club division

were in New York. [The book club advertisements were full page ads together with the contract application (Deposition of Bercovici, pp. 8-9).]

Robert D. Cole was vice-president and general manager of the audio-visual division of the Popular Science Publishing Company. The company published Popular Science and Outdoor Life (Deposition of Cole, pp. 5-6). The audio-visual division sold film strips, overhead transparencies and films to elementary and secondary schools (Deposition of Cole, p. 8). They dealt with ordinary school subjects (Deposition of Cole, p. 9). These products were sold in California in 1965 by two salesmen and delivered by mail thereafter (Deposition of Cole, pp. 10-11). The salesmen were employees of Popular Science Publishing Company and paid salary and commission [CT 11-12]. The salesmen went directly to the schools to make the sales (Deposition of Cole, p. 12). The orders obtained were sent to New York and were processed for mail delivery (Deposition of Cole, p. 13). The salesmen carried samples and catalogues (Deposition of Cole, p. 15).

During the year 1965, Popular Science, through its book club, sold books to Californians and said books were delivered through the mail. The purchase and use of the books by the Californians from an entity outside the state is subject to use tax, which is due from the users. (There is no dispute here that a taxable transaction had taken place. The only issue before the court is whether California had jurisdiction to require Popular Science to collect the use tax from its

California customers. *See* Rev. & Tax. Code § 6203.) The Board assessed the amount of the tax against Popular Science on the basis that it had jurisdiction to require Popular Science to collect the tax from the purchaser-users, and since Popular Science had failed to collect and remit the tax, it was liable to pay to the Board an amount equal to the tax. (*See Bank of America v. State Bd. of Equal.*, 209 Cal. App. 2d 780, 799-802 (1962).)

Summary of Argument

The California use tax collection liability here imposed with regard to Popular Science's mail order sales of books to California residents arises under California Revenue and Taxation Code section 6203 which requires, for purposes here relevant, that foreign retailers maintaining offices in California collect the use tax. This requirement does not penalize the foreign retailers; on the contrary, it merely subjects them to a tax equal to the California sales tax borne by local retailers thereby promoting competitive parity.

Under the decisions of this Court, Popular Science's California activities are not required to bear a direct relationship to the mail order sales constituting the measure of the disputed use tax collection liability. The Due Process Clause and Commerce Clause tests described by this Court do not impose such a relational requirement but rather look to whether the State has given anything for which it can ask return. *Wisconsin v. J. C. Penney Co.*, 311 U.S. 435, 444 (1940). Popular Science's maintenance of the California soliciting offices satisfies this test.

The decision of this Court in *National Bellas Hess v. Department of Revenue*, 386 U.S. 753 (1967),

does not set forth a requirement that a relationship exist between the local activity and the transaction taxed. The lack of nexus condemned in that case could be cured without imposing such a relational requirement. The *National Bellas Hess* Court invalidated the tax based upon the total absence of any local activities other than the use of common carrier and the U.S. mail. This defect is cured by requiring that the foreign retailer have additional physical presence in the taxing jurisdiction; to further require that that physical presence be interrelated with the transaction taxed would be illogical and unnecessarily restrictive of the state's taxing power.

The Court in *Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359 (1941) and *Nelson v. Montgomery Ward*, 312 U.S. 373 (1941), in upholding the constitutionality of requiring mail order retailers with separate retail outlets within the taxing jurisdiction to collect use taxes, held that the absence of a relationship between a foreign retailer's local activities and the transaction taxed was immaterial.

The "dissociation" test set out in *American Oil Co. v. Neill*, 380 U.S. 451 (1964) and *Norton Co. v. Department of Revenue*, 340 U.S. 534 (1951), requires that a relationship exist between the transaction taxed and the taxing jurisdiction in those instances where the legal incidence of the tax imposed falls on the foreign retailers. As the instant case involves a use tax collection requirement, the legal incidence of which falls upon the California user, the "dissociation" test is inapplicable because the relationship between the taxable transaction (the local use) and the taxing jurisdiction is self evident.

The decision of *Miller Bros. Co. v. Maryland*, 347 U.S. 340 (1954) is inapposite to the resolution of the instant controversy. It turned upon a defect in the relationship between the foreign retailer and the transaction taxed. Residents of the taxing jurisdiction purchased items over the counter from border stores in foreign states. The Court struck down the use tax collection liability on those sales because it was uncertain whether the purchasers actually returned to the taxing jurisdiction to use the items purchased. No such defect is present in the instant case.

Finally, even if a relationship between Popular Science's local activities and the transaction taxed were required, it could be found on the facts of this case.

Popular Science personally sold merchandise in California which was similar in nature to that sold by mail order during the period here in controversy, thus putting this case on all fours with the *Sears, Roebuck* case. Moreover, the prestige of Popular Science, largely established by the Magazines, enhanced the saleability of the mail order books. Finally, both Popular Science's California activities and its mail order sales enhanced its basic corporate purpose of increasing and diffusing scientific knowledge.

ARGUMENT

I

THE USE TAX COLLECTION LIABILITY IN QUESTION WAS IMPOSED IN CONFORMANCE WITH CALIFORNIA LAW

We are here concerned with the California use tax which is complemental to the California sales tax on tangible personal property. See sections 6051, 6203 and 6401 of the Revenue and Taxation Code.[2] Section 6203 requires every "retailer engaged in business in this state and making sales of tangible personal property for storage, use or other consumption in this state" to collect use taxes from the purchaser. Section 6204 provides that the retailer is indebted to the state for any taxes which it is required to collect. The retailer becomes so indebted regardless of whether or not the use tax is collected. If the use tax is not collected, the retailer is liable for default in the performance of its duty as a collection agent for the state. *Bank of America v. State Bd. of Equal.*, 209 Cal. App. 2d 780, 793; 26 Cal. Rptr. 348, 355 (1962).

Popular Science's activities in California bring it within the coverage of section 6203 and therefore place it under a duty to collect use taxes upon the sales in question. Section 6203 expressly provides that the phrase "retailer engaged in business in this state" as used therein includes (among other descriptions not relevant to the instant controversy) "[a]ny retailer maintaining, occupying or using, permanently or temporarily, directly or indirectly, or through a subsidiary,

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[2]All references to statutory sections hereinafter made shall be to the California Revenue and Taxation Code unless expressly noted otherwise.

or agent, by whatever name called, an office, place of distribution, sales or sample room or place, warehouse or storage place or other place of business." The employment by Popular Science of two salesmen within California therefore establishes it to be such a "retailer engaged in business in this state." The California District Court of Appeal, in upholding the use tax collection liability below, plainly so held. 16 Cal. 3d 637, 642; 547 P. 2d 458, 460-61.

Moreover, the imposition of a use tax collection liability measured by Popular Science's total sales to Californians best fulfills the purposes of the use tax law as well. The basic purpose of the use tax law is to provide for competitive parity by charging foreign retailers doing business in California with a use tax collection liability equivalent to the sales tax paid by competing local retailers.

A more complete description of this purpose is detailed in an article entitled *The California Use Tax*, 24 Cal. L. Rev. 175, by Roger Traynor, former Chief Justice of the California Supreme Court. It is initially observed therein that the operation of a local sales tax without a complemental use tax penalizes local retailers by permitting foreign competitors to undercut their prices by selling ex tax. The author therefore preliminarily concludes:

> "If the state sales taxation is to continue, states must find some way of equalizing the competition which now threatens their sources of revenue as it threatens their local businesses." *Id.* at 175.

This equalization is found in the complemental use tax law; however, the use tax alone could not equalize the competition because:

> "Any attempt to collect a use tax from countless individual users of commodities would involve so much supervision and expense as to vitiate the exercise of a state's jurisdiction over them. The users might have a clear responsibility for tax payment, but they might evade it by virtue of their numbers." *Id.* at 181.

Accordingly, the use tax collection liability is necessary.

This Court has recognized the validity of this purpose in *Henneford v. Silas Mason Co.*, 300 U.S. 577 (1936), wherein it said of the Washington use tax law:

> "The practical effect of a system thus conditioned is readily perceived. *One of its effects must be that retail sellers in Washington will be helped to compete upon terms of equality with retail dealers in other states* who are exempt from a sales tax or any corresponding burden. Another effect, or at least another tendency, must be to avoid the likelihood of drain upon the revenue of the state, buyers being no longer tempted to place their orders in other states in the effort to escape payment of the tax on local sales." (Emphasis added.) *Id.* at 581.

For purposes of the instant action, Popular Science is such a foreign retailer who, absent the imposition of a use tax collection liability, would enjoy a competitive advantage over local retailers by being able to offer lower prices selling ex tax. Imposition of this liability thus comports with the spirit, as well as the letter, of the California use tax law.

II

THE CALIFORNIA ACTIVITIES OF POPULAR SCIENCE SATISFY THE REQUIREMENTS OF THE DUE PROCESS CLAUSE AND COMMERCE CLAUSE

A. Popular Science's California Activities Support the Constitutional Imposition of the Challenged Use Tax Collection Liability, Regardless of Whether or Not These Activities Were Related to the Transactions Taxed

1. The Due Process Clause and Commerce Clause Tests Have Never Been Described by This Court as Requiring a Relationship Between the Local Activity and the Transaction Taxed

The Due Process Clause and the Commerce Clause are closely related insofar as similar standards have been applied by the courts to determine whether state tax laws are constitutional thereunder. *National Bellas Hess v. Dept. of Revenue, supra,* 386 U.S. 753, 756 (1967). These standards are incorporated into a test of nexus or minimum contact between the taxpayer and the taxing jurisdiction which is necessary to support a finding that the tax is constitutionally imposed. Although the test has been variously stated, an oft quoted definition of what constitutes nexus is set forth in *Wisconsin v. J. C. Penney Co., supra,* 311 U.S. 435, 444 (1940), wherein this Court noted:

> "That test is whether property was taken without due process of law, or, if paraphrase we must, whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return." *Id.* at 444.

This definition does not engraft the requirement of a relationship between the local contact and the transaction taxed. The requisite "fiscal relation" is established by the fact that the foreign retailer has entered the state and benefited as a result. In the instant case, for example, it can be readily seen that Popular Science has secured substantial benefits from its activities within California over and above those associated with its mail order business. By virtue of the protection conferred by this State, Popular Science has been able to establish and maintain employee staffed offices throughout the state from which to solicit sales revenues for the Magazine. Further, the very opportunity of having a market of potential advertisers in California from whom to solicit business is a benefit conferred by the state insofar as its laws protect them and permit their continued existence. The net result of these activities is obviously beneficial insofar as it provides Popular Science with advertising dollars from California businesses.

Certainly the above benefits justify requiring Popular Science to collect a use tax on its mail order sales to Californians whether or not a relationship exists between the local activity and the transaction taxed. It is asking Popular Science no more than to bear a fair share of the cost of local government.

2. The National Bellas Hess Case Does Not Require a Relationship Between the Local Activity and the Transaction Taxed

This Court in *National Bellas Hess v. Department of Revenue, supra,* 386 U.S. 753 (1967) held that a use tax collection liability could not be imposed upon an out-of-state mail order retailer whose only

contacts with the taxing jurisdiction were through the use of common carriers or the U.S. mail. In so holding, the Court noted that to conclude otherwise would be to:

> ". . . repudiate totally the sharp distinction which these and other decisions have drawn between mail order sellers with retail outlets, solicitors, or property within a State, and those who do no more than communicate with customers in the State by mail or common carrier as part of a general interstate business." 386 U.S. 753, 758.

It is evident from the above quoted material that a mail order seller with property within a state would be subject to taxation upon its mail order sales to the residents of that state. Popular Science's maintenance of two salesmen and their offices and equipment in this state easily qualifies it as a seller with property in California. The Court did not set out a requirement that the property owned bear any relationship to the transaction taxed. On the contrary, the overall import of the *National Bellas Hess* case is that where there is exploitation of the local market by mail order sales, any physical contacts between the retailer and the taxing jurisdiction above and beyond contact "by common carrier or the United States mail" would support the imposition of a use tax collection liability measured by the mail order sales.

Popular Science contends that under the rule of *National Bellas Hess,* a foreign retailer must have some definite link between the instate activities and the mail order sales before he can constitutionally be required to collect a use tax with regard thereto. Jurisdictional

Statement, p. 16. To construe the law in the manner urged by Popular Science would be to render the opinion in *National Bellas Hess* internally inconsistent; moreover, it would impute to the court the intent to overrule *sub silentio Nelson v. Sears, Roebuck & Co.* (1941), 312 U.S. 359, and *Nelson v. Montgomery Ward and Co.* (1941), 312 U.S. 373, despite the fact that it earlier cites both cases with apparent approval. 386 U.S. at 757.

The opinion, as so construed, would be rendered internally inconsistent because such a relational requirement would not square with the Court's recognition, earlier noted, that mere ownership of property within the taxing jurisdiction without more would support the imposition of a use tax collection liability. The opinion, as so construed, would overrule *Sears, Roebuck* and *Montgomery Ward* because these cases held, as will be discussed in more detail *infra,* that the absence of a relationship between the foreign retailer's local activities and the mail order business taxed was irrelevant.

In addition to the foregoing, it is plain upon a review of the basis of the Court's holding in the *National Bellas Hess* case that the constitutional defects it condemned could be cured without requiring that a relationship exist between the retailer's local activities and the transaction taxed. As noted above, the Court in *National Bellas Hess* considered objections raised under both the Due Process Clause and the Commerce Clause. These two sources of objection will be discussed separately in this regard.

The Due Process Clause requires that some benefit be conferred by the taxing jurisdiction for which a

return could be asked. *Wisconsin v. J. C. Penney Co., supra,* 311 U.S. 435, 444 (1940). On the facts of the *National Bellas Hess* case, it is clear that the foreign retailer benefited insofar as it had customers in the taxing jurisdiction whose continued existence was dependent upon the protection afforded them by that state. Therefore, if the Court had held due process requirements satisfied under those facts, the decision would have been logically consistent with the fairness requirements underlying concept of due process. Indeed, in the related area of *in personam* jurisdiction over foreign entities, the Court did so hold. In *McGee v. International Life Ins. Co.,* 355 U.S. 120 (1957), *in personam* jurisdiction was upheld upon the basis of a commercial exploitation of the forum state despite the absence of any physical presence therein by the foreign corporations sued. This state of affairs has prompted at least one commentator to speculate that "[i]n light of the striking similarity between jurisdiction for the purpose of taxation and jurisdiction for the purpose of exercising judicial power,[3] the court in *Bellas Hess* could easily have adopted the economic exploitation test in lieu of the archaic and artificial standard demanding physical nexus." 20 Case Western Reserve Law Review 597, 605-606, fn. 42. While the Court in *National Bellas Hess* indicated the need for a physical presence over and above this mail order economic exploitation, it would be unduly restrictive to the state's taxing power to further require that it be related to

[3]The author noted that the due process tests in the areas of taxation and *in personam* jurisdiction are very similar, citing *Erlanger Mills, Inc. v. Cohoes Fibre Mills, Inc.,* 239 F. 2d 502 (4th Cir. 1956) and *International Shoe Co. v. Washington,* 326 U.S. 310, 321 (1945). 20 Case Western Reserve Law Review 597, 605-606, fn. 42.

any particular transaction. It should be enough that the foreign retailer receives some form of protection, opportunity or benefits, independent of the mail order exploitation, for which the state can ask return. As noted previously, Popular Science has so benefited from its California activities.

With regard to the Commerce Clause, the opinion of the Court in *National Bellas Hess* turned upon the administrative entanglements which the majority felt would unduly burden interstate mail order businesses if every state, municipality, school district and other political subdivisions were allowed to impose sales and use taxes at varying rates with varying administrative and record keeping requirements. 386 U.S. 753, 759-60. In keeping with the above, it is unnecessary to construe *National Bellas Hess* as requiring that a retailer's local activities be related to the taxable transaction. All that is needed to cure the defect found in that case is the requirement of a voluntary physical presence, independent of mail order sales, as a condition precedent to taxability. Thus, permitting use tax collection liabilities to be imposed with regard to mail order sales of foreign retailers who have voluntarily entered the taxing jurisdiction and established a business office will not result in the administrative entanglement condemned in *National Bellas Hess.* The number of taxing jurisdictions in which the typical mail order retailer has business offices will doubtless be small; moreover, the mail order retailer would be able to control his

susceptibility to such taxation by choosing selectively where he would maintain such offices.

It is appropriate to mention at this point that all of the bills recently introduced in Congress which relate to the imposition of a jurisdictional standard for state sales and use taxation of interstate commerce provide that a person may constitutionally be subjected to a use tax collection liability if that person owns or leases real property within the state without limitation as to whether said ownership or leasing was related to the transaction taxed.[4] This is especially noteworthy in light of the fact that most of these bills proposed general cutbacks in the power of the states to impose use tax collection liabilities upon foreign retailers under other circumstances such as those held taxable in *Scripto v. Carson*, 362 U.S. 207 (1961), thus reflecting the belief that, at least with regard to leasing or ownership of property, a foreign retailer's local activities within the taxing jurisdiction clearly subject it to tax despite the lack of any relationship to the transaction taxed. Because, as noted in *National Bellas Hess*, the Congress is vested with the power of regulation and control under the Commerce Clause (386 U.S. 753, 760), this belief upon the part of all its members introducing such bills is significant.

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[4]89th Congress: H.R. 11798, H.R. 16491; 90th Congress: H.R. 2158; 91st Congress: H.R. 2179, H.R. 3835, H.R. 4178, H.R. 7906, S. 611, S. 916, S. 2804; 92nd Congress: H.R. 1538, H.R. 4267, S. 317, S. 1210; 93d Congress: H.R. 977, H.R. 1453, S. 282, S. 1245, S. 1982, S. 2811; 94th Congress: H.R. 9, S. 28.

3. The Sears, Roebuck and Montgomery Ward Cases Hold That No Relationship Need Exist Between the Local Activity and the Transaction Taxed

In *Nelson v. Sears, Roebuck & Co., supra,* 312 U.S. 359 (1941), this Court upheld the imposition of an Iowa use tax collection liability measured by mail order sales of an out-of-state retailer with Iowa retail outlets. The retailer there advanced the argument that the disputed mail order sales were unrelated to the presence of its retail outlets in Iowa. The use tax collection liability was upheld despite this argument. The Court noted that Iowa, by virtue of the retailer's contacts with it, was entitled to tax the retailer's entire Iowa business. Thus, it noted:

> "Whatever may be the inspiration for these mail orders, however they may be filled, Iowa may rightly assume that they are not unrelated to respondent's course of business in Iowa. They are nonetheless a part of that business though none of respondent's agents in Iowa actually solicited or placed them. Hence to include them in the global amount of benefits which respondent is receiving from Iowa business is to conform to business facts." 312 U.S. 359, 364.

The clear implication of the court's observations in this regard is that a direct relationship between the retailer's local activities and the mail order sales constituting the measure of the use tax collection liability need not be proven. Moreover, this of necessity had to be so, for otherwise the Court could not have upheld the use tax collection liability without observing that there had been satisfactory proof of the existence of such a relationship. The mere fact of over-the-counter

sales at Sears' retail outlets in Iowa cities cannot realistically be said to constitute proof of a relationship to the catalogue mail order sales to residents of the outlying rural areas of Iowa.

In the related case of *Nelson v. Montgomery Ward, supra,* 312 U.S. 373 (1941), in passing upon the same issue, this Court found testimony relating to the absence of a relationship between the retailer's local activities and the taxable transaction was "immaterial". 312 U.S. at 375. The *Montgomery Ward* case has accordingly been cited in support of the proposition that the local activities of a foreign retailer need not have a causal relation to the sales in which the tax is levied. 81 Harvard L. Rev. 69, 215, fn. 14.

4. The "Dissociation" Test Applicable in Measuring the Validity of Excise Taxes the Incidence of Which Falls Upon Foreign Retailers Is Inapposite to the Resolution of the Instant Controversy

Popular Science alludes in its Jurisdictional Statement to the "dissociation" test set forth in *American Oil Co. v. Neill, supra,* 380 U.S. 451 (1964) and *Norton Co. v. Department of Revenue, supra,* 340 U.S. 534 (1951). In relying upon these cases, Popular Science refuses to come to grips with the fact that the excise taxes there involved fell upon the foreign retailers whereas the use tax involved in the instant case falls upon the local California purchaser. This difference is crucial insofar as different standards of nexus are applied with regard to testing the validity of taxes falling on the foreign retailer.

As touched upon previously, the California use tax has its incidence upon the California purchasers who store, use or consume the products purchased from

foreign retailers. *See Bank of America v. State Bd. of Equal., supra,* 209 Cal. App. 2d 780, 793, 26 Cal. Rptr. 348 (1962). The foreign retailer is liable for his default in the performance of his duty as collection agent of this tax under California Revenue and Taxation Code section 6203. *Id.* at 799.

The significance of the distinction between a use tax collection liability, where the incidence of the tax is on the local purchaser, and liability for an excise tax imposed directly upon the out-of-state retailer itself was recognized by this Court in *Norton Co. v. Dept. of Revenue, supra,* 340 U.S. 534 (1951), where, in passing upon the constitutionality of a gross receipts tax imposed upon a nonresident retailer, it declared inapposite cases involving the collection of taxes attributable to the local buyer observing that a state imposing use taxes can more easily meet the burden of demonstrating sufficient nexus to support the tax because the impact of those taxes is on the local buyer or user. In that regard, the Court said:

> "Where a corporation chooses to stay at home in all respects except to send abroad advertising or drummers to solicit orders which are sent directly to the home office for acceptance, filling, and delivery back to the buyer, it is obvious that the State of the buyer has no local grip on the seller. Unless some local incident occurs sufficient to bring the transaction within its taxing power, the vendor is not taxable. McLeod v. Dilworth Co., 322 U.S. 327. Of course, *a state imposing a sales*[5] *or use tax can more easily*

[5]The reference to a "sales" tax at this point is explained by the fact that some states have sales taxes the incidence

(This footnote is continued on next page)

> *meet this burden, because the impact of those taxes is on the local buyer or user. Cases involving them are not controlling here, for this tax falls on the vendor.*" (Emphasis added). 340 U.S. at 537.

The distinction is justified because the local buyer or user has obvious contacts with the taxing jurisdiction, therefore a tax whose incidence falls upon such buyers or users is more easily sustainable. This is a difference in substance and not merely form. In *McLeod v. Dilworth Co.*, 322 U.S. 327 (1944), the Court noted:

> ". . . we are not dealing with matters of nomenclature even though they be matters of nicety. 'The state court could not render valid, by misdescribing it, a tax law which in substance and effect was repugnant to the Federal Constitution, neither can it render unconstitutional a tax, that in its actual effect violates no constitutional provision, by inaccurately defining it.' Wagner v. City of Covington, 251 U.S. 95, 102. Though sales and use taxes may secure the same revenues and serve complementary purposes, they are, as we have indicated, taxes on different transactions and for different opportunities afforded by a State." *Id.* at 331.

Perhaps the best illustration of the effect of this distinction is a comparison of the *McLeod* case and *General Trading Co. v. Tax Comm'n*, 322 U.S. 335 (1944).

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of which falls upon the *consumer* rather than the vendor. See State and Local Taxation, John F. Due (1971), pp. 24-26. Illinois (at the time of the *Norton* decision) had a sales tax the incidence of which was on the vendor and therefore the court was holding inapplicable decisions involving consumer type sales taxes and use tax collection liabilities such as are present in this case.

These two cases were argued and decided on the same dates and presented virtually identical facts save and except that *McLeod* involved a sales tax upon an out-of-state retailer and *General Trading Co.* involved a use tax collection liability imposed upon an out-of-state retailer. In both cases the out-of-state corporations were not qualified to do business in the taxing state and had no office or place of business there but did solicit orders from its residents by traveling salesmen. In the *McLeod* case, the sales tax was held unconstitutional; in the *General Trading Co.* case, the use tax collection liability was upheld. The dissents in both cases make it apparent that the majority reached different results in the two cases solely because of the nature of the tax imposed.

Similarly, *McLeod* also can be contrasted with *Scripto v. Carson*, 362 U.S. 207 (1960), where on comparable facts, the Court upheld the constitutionality of a use tax collection liability imposed upon the nonresident retailer. The facts of these two cases were recognized as indistinguishable in 81 Harv.L.Rev. 69, 216.

Just as the *Norton* case has been shown to be inapplicable to the instant controversy, so is the case of *American Oil Co. v. Neill, supra*, 380 U.S. 451 (1964). In that case, an Idaho State Tax Collector imposed an excise tax on an out-of-state motor fuel dealer. *Id.* at 454, 455. The court expressly adopted the findings of the trial judge that the incidence of the tax was on the dealer not the local user. *Id.* at 456-57.

5. The Decision of This Court in Miller Bros. Co. v. Maryland, 347 U.S. 340 (1954) Is Inapposite to the Resolution of the Instant Controversy

Popular Science makes reference to the decision of this Court in *Miller Bros. Co. v. Maryland, supra,* 347 U.S. 340 (1954). As is shown below, the *Miller Bros.* case is not germane to the question here presented because the Court's finding of insufficient nexus in that case turned upon defects not present in the instant case.

In *Miller Bros. Co. v. Maryland, supra,* 347 U.S. 340 (1954), the Court invalidated a Maryland use tax collection liability imposed with regard to the sales of merchandise by a Delaware corporation from its Delaware store to visiting Maryland customers. The merchandise purchased from the Delaware store was either handed to the customer over-the-counter or delivered to the customer's Maryland address by common carrier or the vendor's vehicle. The Court, in holding the Maryland use tax collection requirement unconstitutional, noted that it was uncertain as to whether merchandise sold over-the-counter was actually transported to Maryland prior to use. 347 U.S. 340, 344.

It is clear from the above that the Court's holding in *Miller Bros.* turned upon a defect in the relationship between the foreign retailer and the transaction taxed which is not present in the instant case. This defect was aptly described by the California Supreme Court in this case as follows:

> "The court in denying tax liability noted that no one was liable for a use tax until the merchandise was imported into the taxing state. When there is an over-the-counter out-of-state sale, the

> taxable event, use occurs only after the sale is complete; the seller has no control over that use. When discussing Miller Bros. in Scripto v. Carson, supra, 362 U.S. 207, 212 [4 L.Ed.2d 660, 664-65], the Supreme Court declared that it was impossible for Miller to determine that goods sold for cash to a customer over the counter at its store in Delaware were to be used and enjoyed in Maryland. The use in the taxing state must be certain from the retailer's own actions and not just known to him from other factors. Knowledge is an insufficient connection to uphold a tax against attack under the due process clause. (American Oil Co. v. Neill, supra, 380 U.S. 451, 457 [14 L.Ed 2d 1, 6].)" 16 Cal. 3d 637, 649-50; 128 Cal. Rptr. 682, 690.

In direct contrast, Popular Science in the instant case shipped all purchases directly to its California customers inside California; hence no uncertainty or gaps intervene between the Popular Science's mail order sales and the California purchaser's subsequent use.

In addition to the foregoing, *Miller Bros.* may be distinguished from the instant case because the foreign retailer in that case did not directly exploit the market of the taxing State. Thus, the Court in *Miller Bros.* emphasized that the Delaware based foreign retailer did not engage in solicitation in Maryland, the taxing jurisdiction, "other than the incidental effects of general advertising" in Delaware and that there had been "no invasion or exploitation of the consumer market in Maryland," thereby recognizing the *incidental* nature of the solicitation of the Marylanders there involved. 347 U.S. 340, 347. Stated in another way, the Delaware store did not direct an advertising campaign specifically

against the residents of Maryland; rather, its general advertising directed to potential customers in the vicinity of the store spilled over into Maryland as well as reaching residents of Delaware. Further, the purchasers did not deal with the store from their residences but had to leave Maryland and visit the store in Delaware. This situation prompted this Court in *Scripto v. Carson, supra,* 362 U.S. 207 (1960), to characterize the facts of *Miller Bros.* as follows:

> "True, there was an 'occasional' delivery of such purchases by Miller into Maryland, and it did occasionally mail notices of special sales to former customers; but *Marylanders went to Delaware to make purchases—Miller did not go to Maryland for sales.*" (Emphasis added.) 362 U.S. 207, 212.

All of the above described factors, which led the Court in *Miller Bros.* to find that there had been no exploitation of the Maryland market, are absent in the instant case. Popular Science specifically directed its advertising campaign for the sales of books against its California subscribers. This solicitation was continuous in the form of repeated advertisements in the Magazine and mailed announcements sent throughout all periods relevant hereto. Finally, Popular Science did not wait for these California residents to come to its out-of-state stores, but enclosed with the advertisements mail order coupons which were completed and sent directly to Popular Science. It is clear that under the rationale of the *Miller Bros.* case Popular Science has exploited the California market.

For all the foregoing reasons, the *Miller Bros.* case is inapposite.[6]

B. In Any Event, Popular Science's California Activities Are Not Unrelated to the Transaction Taxed

It has been shown in the preceding section of this motion that the tests of the Due Process Clause and Commerce Clause do not require that there be a relationship between the local activities of a foreign retailer and the transaction taxed. Nevertheless, assuming for the sake of argument that such a relationship were required, it is clear that it is present in the instant case.

This is perhaps made most apparent when the instant case is compared with *Nelson v. Sears, Roebuck & Co., supra,* 312 U.S. 359 (1941).

Popular Science's other California contacts bear a stronger relationship to the mail order sales than those before the Court in *Sears, Roebuck*. In *Sears, Roebuck,* the existence of the retail outlets in Iowa must be said to contribute to some unknown extent to the generation of mail order sales. In the instant case, Popular Science's California based employee offices

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[6]The case of *Montgomery Ward & Co. v. Bd. of Equalization,* 272 Cal. App. 2d 728, 78 Cal. Rptr. 373 (1969), cert. den. 396 U.S. 1040, cited by Popular Science can be distinguished on the same grounds as *Miller Bros.* insofar as it involved a California use tax collection liability imposed with regard to over-the-counter sales of goods by an out-of-state retailer from its Reno, Nevada and Klamath Falls, Oregon stores to customers with California addresses. As the California Supreme Court below noted, the constitutional defect in the *Montgomery Ward* case "lay in the lack of uncertainty between the seller's activities and the event to be taxed, namely the use." 16 Cal. 3d 637, 649; 128 Cal. Rptr. 682, 690.

were related to the mail order sales here in controversy, by virtue of the following facts:

(1) Popular Science's California solicitation of audio-visual sales to schools and libraries from those offices provided revenues which enured to the magazine;

(2) The Magazine served as the basic vehicle through which the advertisements of books in question were communicated to Popular Science's California customers;

(3) The list of the subscribers to Popular Science and Outdoor Life provided the mailing list of California residents to whom Popular Science sent its flyers;

(4) The prestige and goodwill of the Magazines carried over to products sold under Popular Science's name.

It is thus submitted that if, indeed, a relationship between the local activities and the transactions taxed was required at all by the *Sears, Roebuck* Court, it is satisfied in the instant case as it was in that case.

Popular Science has attempted to distinguish the holding in *Sears, Roebuck* upon the ground that the foreign retailer in that case was qualified to do business within the taxing jurisdiction. Jurisdictional Statement, page 17. In that regard, Popular Science has gone outside the proven record before this Court and asserted that it was not similarly qualified to do business in California. This suggestion conflicts with the record insofar as it is stipulated that Popular Science did sell tangible personal property in California and therefore, pursuant to the presumption that things are lawfully done,[7] it must be presumed that Popular Science

[7] *McFarland v. Campbell*, 213 F.2d 855, 858 (1954).

complied with California Revenue and Taxation Code section 6066 and secured a seller's permit. It paid sales taxes. Jurisdictional Statement, page 17. Moreover, even if it were assumed that Popular Science did not seek a seller's permit, it should nevertheless be estopped to deny the lack of having qualified to do business in California in light of its stipulated admission that it did in fact do business in this state; otherwise, a business violating the law would enjoy an advantage over the law-abiding business which had secured a seller's permit.

Furthermore, the result reached in *Sears, Roebuck* should not have been otherwise if the retailer in that case had not been registered to do business within that state. Although the Court there speculated hypothetically that the lack of qualification to do business within the taxing jurisdiction might result in an inability to tax occasioned by the impotence of state power, it went on to find that the taxpayer's local activities in the taxing jurisdiction supported taxation of its mail order business. 312 U.S. 359, 364. Thus, the Court recognized that the presence or absence of qualification to do business within the taxing jurisdiction was superfluous to the conclusion it reached on the facts before it. Moreover, this Court has easily found sufficient nexus to support the imposition of a use tax collection liability against foreign corporations in other cases before it despite the fact that the corporation was not licensed to do business in the taxing state. *Felt & Tarrant Mfg. Co. v. Gallagher*, 306 U.S. 62 (1939); *General Trading Co. v. Tax Comm'n*, 322 U.S. 335 (1944). It follows that Popular Science's arguments in this regard should be dismissed as irrelevant.

Finally, a relationship between Popular Science's California activities and the disputed mail order sales can be said to exist insofar as both activities further the basic objective of Popular Science: the increase and diffusion of scientific knowledge.

Conclusion

In light of the fairness concept underlying the Commerce Clause and Due Process Clause, it would be improper to do more than require that foreign retailers who are substantially exploiting a state's mail order market have some physical presence within that jurisdiction to become subject to a use tax collection requirement with regard to their mail order sales. To impose the further requirement that a relationship must exist between this physical presence and the mail order sales would needlessly sacrifice the states' taxing power and cripple its ability to protect its local retailers from an unfair competitive advantage thereby conferred upon foreign retailers who are free to sell ex tax.

Even were this not so, it is plain that Popular Science's California activities relate to the transaction taxed.

It is respectfully submitted that the judgment below be affirmed.

Dated: February 9, 1977.

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APPENDIX A.

California Statutes Involved.

California Revenue and Taxation Code Section 6051:

For the privilege of selling tangible personal property at retail a tax is hereby imposed upon all retailers at the rate of 2½ percent of the gross receipts of any retailer from the sale of all tangible personal property sold at retail in this state on or after August 1, 1933, and to and including June 30, 1935, and at the rate of 3 percent thereafter, and at the rate of 2½ percent on and after July 1, 1943, and to and including June 30, 1949, and at the rate of 3 percent on and after July 1, 1949, and to and including July 31, 1967, and at the rate of 4 percent thereafter.

California Revenue and Taxation Code Section 6066:

Every person desiring to engage in or conduct business as a seller within this State shall file with the board an application for a permit for each place of business. Every application for a permit shall be made upon a form prescribed by the board and shall set forth the name under which the applicant transacts or intends to transact business, the location of his place or places of business, and such other information as the board may require. The application shall be signed by the owner if a natural person; in the case of an association or partnership, by a member or partner; in the case of a corporation, by an executive officer or some person specifically authorized by the corporation to sign the application, to which shall be attached the written evidence of his authority.

California Revenue and Taxation Code Section 6203:

Except as provided by Section 6292 and 6293 every retailer engaged in business in this state and making sales of tangible personal property for storage, use, or other consumption in this state, not exempted under Chapters 3.5 or 4 of this part, shall, at the time of making the sales or, if the storage, use, or other consumption of the tangible personal property is not then taxable hereunder, at the time the storage, use, or other consumption becomes taxable, collect the tax from the purchaser and give to the purchaser a receipt therefor in the manner and form prescribed by the board.

As respects leases constituting sales of tangible personal property, the tax shall be collected from the lessee at the time amounts are paid by the lessee under the lease.

"Retailer engaged in business in this state" as used in this and the preceding section means and includes any of the following:

(a) Any retailer maintaining, occupying, or using, permanently or temporarily, directly or indirectly, or through a subsidiary, or agent, by whatever name called, an office, place of distribution, sales or sample room or place, warehouse or storage place or other place of business.

(b) Any retailer having any representative, agent, salesman, canvasser or solicitor operating in this state under the authority of the retailer or its subsidiary for the purpose of selling, delivering, or the taking of orders for any tangible personal property.

(c) As respects a lease, any retailer deriving rentals from a lease of tangible personal property situated in this state.

California Revenue and Taxation Code Section 6204:

The tax required to be collected by the retailer and any amount unreturned to the customer which is not tax but was collected from the customer under the representation by the retailer that it was tax constitutes debts owed by the retailer to this state.

California Revenue and Taxation Code Section 6362:

(a) There are exempted from the taxes imposed by this part, the gross receipts from the sale of, and the storage, use, or other consumption in this state, of tangible personal property which becomes an ingredient or component part of any newspaper or periodical regularly issued at average intervals not exceeding three months and any such newspaper or periodical.

(b) There are exempted from the taxes imposed by this part, the gross receipts from the sale of, and the storage, use, or other consumption in this state, of a photograph, whether or not produced to special order, when the possession, but not the title, of the photograph is transferred for the purpose of being reproduced one time only, in a newspaper regularly issued at the intervals set forth in subdivision (a) of this section.

California Revenue and Taxation Code Section 6401:

The storage, use, or other consumption in this state of property, the gross receipts from the sale of which are required to be included in the measure of the sales tax, is exempted from the use tax; provided, however, that this exemption does not extend to the possession of, or the exercise of any right or power over, tangible personal property by a lessee under a lease.